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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957.

No. 675

RAYMOND S. MILLER and JOSEPHINE MILLER

and

FRANK NOWATZKI and LILLIAN NOWATZKI,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REHEARING OF ORDER ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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Raymond S. Miller, Josephine Miller, Frank Nowatzki and Lillian Nowatzki, petitioners, filed herein their petition for writ of certiorari to the United States Court of Appeals for the Seventh Circuit. This petition was denied on February 3, 1958.

Petitioners now respectfully request rehearing of the order denying the petition for certiorari on grounds of substantial and controlling effect set forth herein.

STATEMENT.

The Tax Court of the United States held a dividend taxable as ordinary income to the seller of stock, since he owned and controlled the shares at the time the dividend was declared, and the dividend was made payable to and paid to him (Joint Appendix, page 30).

In that opinion (Joint Appendix, page 40), Judge Tietjens stated that the agreement for the sale of stock was dated July 29, 1950; that the dividend was declared the same day, made payable on August 4, 1950, out of the earned surplus of the corporation, to the shareholders of record on July 28, 1950.

That Court stated that the reasoning in cases cited was helpful (Joint Appendix, page 43). Based on these decisions, the Judge of the Tax Court found that there had been no intention to make a transfer of ownership of the stock prior to the declaration of the dividend; that the seller executed an assignment and transfer of the shares on August 4, 1950, bearing out that it was not intended that ownership of shares be passed upon execution of agreement of sale; that the parties did not consider the transaction consummated at the time the agreement of sale was executed because of the holding of the special meeting of the board of directors of the corporation to give consent to the sale; and that something more than the mere execution of the agreement was to be done before the agreement would become effective, there being a provision that as a condition precedent to the agreement's becoming effective, the seller and the corporation had to furnish buyers with a certified balance sheet of the business as of July 31, 1950.

From the Tax Court decision (Joint Appendix, page 45), we quote:

"The inference we draw from the circumstances of the agreement that we have dwelt upon is that it was not the intention of the parties that ownership of the stock in question should pass upon execution of the agreement and that beneficial ownership was not in the buyers when the dividend was declared. In our view these circumstances point up the difference between this case and *Moore* v. *Commissioner, supra.* One ground for the Court's decision in *Moore*, as we have pointed out, was that at the time the dividend was declared, the stock being sold was completely beyond the seller's control and nothing further remained for her to do to divest herself of title to the shares. Here it is apparent that such was not the case; here the seller himself made a formal assignment of the shares to the buyers six days after the agreement was executed and the dividend declared. The most plausible inference to be drawn from this, we think, is that the seller had ownership and control of the shares when the dividend was declared; this being so, the dividend that was declared payable to him (as record owner of the shares on July 28, 1950) and that was actually paid to him, should properly be included in his income in the year received.

"The fact that the parties in one part of their agreement included the dividend as part of the purchase price of the shares does not necessarily alter the tax consequences of its payment. In another part of the agreement it was provided that the dividend in question was to be paid to the seller and was to 'apply on or reduce' said sale price (of the stock) 'in such amount.' This, we think, is the essence of the transaction: the corporation had a substantial earned surplus accumulation at the time; such surplus was available to the then stockholder (the seller); a dividend from the surplus was declared on the same day that the

agreement to sell was entered into and while the seller was still in control of the corporation; this dividend was specifically made payable to stockholders of record the day before the date of the agreement (again, the seller); and the dividend was so paid, and according to the agreement, the amount of the dividend reduced the sale price of the stock. On these facts, the dividend was the seller's and was properly taxable to him. * * *.

"In addition to what has been said above in distinguishing the case before us from those relied on by the seller, we point out that those cases involved situations where the stock sold was either placed in escrow or held as collateral by the seller until the purchase price, part of which was to be paid from dividends subsequently declared and at a time when the purchaser was in control of the stock, was paid. The dividends subsequently paid were held taxable to the purchaser. Here the dividend was declared on the same day as the sales agreement, made payable to the person who owned the shares on the day prior to the date of the agreement. The two situations call for different tax consequences."

* * *

Reference is made to the decision of the United States Court of Appeals for the Seventh Circuit (Appendix, page 2a), in which Judge Finnegan states:

"That the dividend was taxable to the seller was the chief contention of the Commissioner who, as he asserts through his brief, 'being charged with the duty of collecting the revenue is occasionally required to take inconsistent positions in order to conform to his duty. The present consolidated proceeding presents such a problem. The Commissioner believes the Tax Court was correct and would not have appealed in the case of the buyers had not

the seller filed a petition for review.' In short, we are told this 'dividend was inexorably income to someone.' Accordingly, the Commissioner filed a protective appeal against the buyers Raymond S. Miller, Josephine Miller, Frank Nowatzki, Lillian Nowatzki when Clarence W. and Emma Miller took their appeals."

* * *

Before the United States Court of Appeals for the Seventh Circuit, the Brief for the Commissioner contains a statement as follows:

"At the time of the dividend the seller had legal title to the shares, his name was on the corporate books as owner, and he possessed the power to vote, without limitation, 45,500 of the 46,700 shares outstanding of the corporation. In addition, he was in full control of the management and policies of the corporation. Indeed, he had possession and control of the shares themselves. Moreover, at the time of the dividend the seller had no right to sue for the purchase price, and the buyers, under the contract, were under no present obligation to pay the balance of the contract price. The seller was also the party who was to bear any liabilities arising from the ownership of the shares.

"On this evidence the Tax Court, following this Court's decisions in *Moore and Northern Trust Co. of Chicago*, and that of the Second Circuit in *DeGuire*, correctly found the dividend taxable income to the seller, as the party in possession of the legal title and beneficial ownership of the shares at the time of the dividend.

"The Commissioner believes the decisions of the Tax Court were correct. The dividend, however, was income to someone, *i.e.*, either the seller or buyers of the shares. Therefore, if this Court should reverse the Tax Court's

decision against the seller, it should find in favor of the Commissioner on his protective appeal against the buyers."

Propositions of law relied upon by the Commissioner in said brief are as follows:

"1. There is no sale of shares of stock where there is no transfer of the shares on the books of the corporation and no delivery of the shares to the buyers, and under the contract to sell the buyers are not liable to pay the balance of the purchase price.

Shinsaku Nagano v. *McGrath*, 187 F. 2d 753 (C.A. 7th).

Nolan v. *American Telephone & Telegraph Co.*, 326 Ill. App. 328, 61 N.E. 876.

"2. A party bound to perform a condition precedent found in a contract cannot sue on the contract without proof that he has performed the condition.

Burke v. *Dulaney*, 153 U.S. 234.

Ware v. *Allen*, 128 U.S. 540.

Jones v. *United States*, 96 U.S. 24.

Lilly v. *Haynes Co-op. Coal Mining Co.*, 56 N.D. 465, 196 N.W. 556.

McIsaac v. *Hale*, 104 Conn. 374, 132 Atl. 916.

Mumaw v. *Western & Southern L. Ins. Co.*, 97 Ohio 1, 119 N.E. 132.

"3. Where there exists an executory contract for the sale of shares of stock, a dividend declared thereon is income to the owner of the shares; the owner of the shares for tax purposes is the party possessing the more substantial attributes of ownership at the time of the dividend.

Northern Trust Co. of Chicago v. *United States*, 193 F. 2d 127 (C.A. 7th), certiorari denied, 343 U.S. 956.

Moore v. *Commissioner*, 124 F. 2d 991 (C.A. 7th).

DeGuire v. *Higgins*, 159 F. 2d 921 C.A. 2d).

"4. The intention of the parties is the controlling factor and such intent may be inferred from the wording of the agreement and from the surrounding circumstances.

Vermont Transit Co. v. *Commissioner*, 218 F. 2d 468 (C.A. 2d).

"5. Among the circumstances to consider in a determination of which party possessed the more substantial attributes of ownership in the shares at the time of the dividend are:

The right to vote the stock;

The right of control over officers, policies and management of the corporation;

Whether or not the shares were out of the seller's control (*i.e.*, endorsed in blank and delivered to the buyer or to an escrow agent on behalf of the buyer) during the time of the dividend;

Whether or not the seller was bound by the contract to credit the dividend in satisfaction of the buyer's obligation to pay the purchase price.

Northern Trust Co. of Chicago v. *United States*, 193 F. 2d 127 (C.A. 7th), certiorari denied, 343 U.S. 956.

Moore v. *Commissioner*, 124 F. 2d 991 (C.A. 7th).

DeGuire v. *Higgins*, 159 F. 2d 921 (C.A. 2d).

"6. No single circumstance is controlling. The incidence of tax falls upon the party who possesses the more substantial attributes of ownership at the time of the dividend.

Hulbert v. *Commissioner*, 227 F. 2d 399 (C.A. 7th).
Northern Trust Co. of Chicago v. *United States*, 193 F. 2d 127 (C.A. 7th) certiorari denied, 343 U.S. 956.
Moore v. *Commissioner*, 124 F. 2d 991 (C.A. 7th).
DeGuire v. *Higgins*, 159 F. 2d 921 (C.A. 2d).

The Commissioner in the argument in said brief states:

"* * * The seller had full control of the stock, had the right to vote the stock as he saw fit, and had control of the management, policies and officers of the corporation; indeed, he had all this and legal title as well."

In commenting upon the dividend, the Commissioner in his brief concludes that July 28, 1950, is the crucial date and, after citing decisions, makes comments:

"Indeed, under Illinois law the buyers here could not be heard to say that the dividend was theirs. Since the buyers and the seller as well, agreed that the dividend be that of shareholders of record as of July 28, 1950, neither could therefore, subsequently take a different position when it appeared more favorable to do so."

"Aside from this, even if the crucial date was July 29, 1950, the result would be the same, for the essential circumstances remained the same."

On the matter of the condition precedent, the Commissioner in said brief states:

"It may do well to point out at this time that we here arrive at a juncture between this case and cases like *Northern Trust Co. of Chicago.* Here the buyers were not bound to pay the balance of the purchase price at the time of the dividend."

Again as to whether seller or buyers received the dividend, the Commissioner, in said brief, states:

"To the extent that the earned surplus was represented by cash not needed by the corporation for the future conduct of its business, it would have been senseless for the buyers to pay value therefore in the form of additional consideration for the shares of stock, and then to be taxed with a dividend when the cash was withdrawn from the corporation since, as we noted, the surplus represented earnings created when the seller was in control of the corporation. It was much more realistic to do as the parties evidently did, namely, have the surplus cash paid as a dividend to the seller (whose efforts helped the corporation create the earnings) and thereby reduce the value of the shares and the purchase price to be paid by the buyers. The provisions of the agreement and the surrounding circumstances reinforce the conclusion that this is what the parties intended and that this is what they did.

"Unlike cases like *Northern Trust Co. of Chicago* and *DeGuire*, here we have an agreement which makes the application of the dividend in reduction of the purchase price depend wholly upon the depletion of assets of the corporation in the form of a dividend, etc., to the seller."

In commenting upon *Villeri* v. *Commissioner*, 133 F. 2d 905 (C.A. 5th) the Commissioner, in said brief, states:

"It would, likewise, be necessary to overcome the general rule that the one who controls the source of income is taxable on the income though the income is given to another under an existing contract."

In summary of the argument in said brief, the Commissioner states:

"Here, at the time of the dividend the seller possessed all the rights attributable to the ownership of stock, as well as the liabilities that ownership of stock brings. Moreover, it was the seller who, in addition, received the economic benefit of the dividend. He received in return all the essential rights previously noted, and retained the right to the continued receipt of his salary as president of the corporation. The dividend checks were his to dispose of as he saw fit.

"The inescapable conclusion in this case is that the greater number of attributes of ownership, at the time of the dividend, were in the seller. That is, comparing beneficial rights we cannot avoid the conclusion that of the two, it was the seller who had many more as to the shares than the buyers. It would seem he had all."

REASONS FOR GRANTING THE WRIT.

1. Confusion has arisen under the decisions involving beneficial ownership of stock at the time of declaration of dividends and this Court should clarify the position for the Commissioner and for taxpayers.

2. There is conflict between this decision on which writ of certiorari is requested and decisions of the United States Supreme Court and of the United States Court of Appeals in other circuits, as shown in the Brief of the Commissioner filed in the United States Court of Appeals

for the Seventh Circuit (a) in that there had been no sale of shares, no transfer of shares, no delivery of shares and no obligation on buyers to pay the balance of the purchase price at the time of the declaration of the dividend; (b) in that the party bound to perform the condition precedent found in the contract could not sue on the contract without proof that he had performed the condition; (c) in that it disregards holdings that the party to be taxed shall be the party possessing the more substantial attributes of ownership at the time; and (d) in that it does not seek to establish the intention of the parties as provided by decisions.

3. No consideration is given to the condition precedent, which is in conflict with many decisions of the United States Supreme Court. That a condition precedent should be considered has been recognized by the Seventh Circuit. In the case of *John K. Teaford v. Commissioner*, 246 F. 2d 73 (7th Cir.), the appeal presented the question of when a sale transaction was considered consummated for tax purposes. Agreement for sale of the partnership interest provided "The partnership * * * shall continue until the First National Bank in St. Louis, Missouri, shall in its uncontrolled discretion consent to the dissolution of the partnership, or until all of the indebtedness of said partnership to said First National Bank in St. Louis, shall have been paid." In that case, Judge Finnegan stated "From the documents of record and the testimony it clearly appears that the sale date was postponed 'until the Bank consented * * *'."

4. The decision is in conflict with the general rule that the one who controls the source of income is taxable on that income, even though the income is assigned to another, as the Commissioner points out in his Brief filed in the Circuit Court of Appeals. The seller withdrew the

surplus of the corporation theretofore earned and he should be taxed thereon.

5. The seller of stock may receive a dividend rather than a capital gain. A decision of the United States Court of Appeals (9th Cir.), *Phelps* v. *Commissioner*, 247 F. 2d 156, concerned a situation where three related automobile agency corporations having a trust as a shareholder adopted a plan whereby the trust would be eliminated by having each corporation redeem shares of the trust and also redeem shares held by individual shareholders, all in order to comply with a manufacturer's policy. All corporations had had successful operations and had paid no dividends. Yet, at the time of the distributions in redemption, the accumulated earnings and profits of each corporation were in excess of the total amount distributed. It was held that the distribution was equivalent to distribution of taxable dividends, for federal income tax purposes.

CONCLUSION.

It is respectfully requested that this Honorable Court reconsider petition for writ of certiorari.

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CERTIFICATE.

The undersigned certifies that this petition is presented in good faith and not for delay. It is restricted to the rule governing grounds specified on petition for rehearing.

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